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SUBJECT: CUKUROVA FAILS TO COME THROUGH AGAIN

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This cable was coordinated with Embassy Ankara.

1. (SBU) Summary: Turkey's stock market was shaken Tuesday as it absorbed news that the Cukurova Group had again missed the deadline for completion of the first payment under its early payment plan with the Turkish Savings Deposit Fund (SDIF). The ISE-100 dropped 2.15 percent Tuesday as a result, with Yapi Kredi Bank, which was slated to receive the bulk of the 130 million USD payment, falling 9.5 percent before trading in its shares was suspended. The apparent failure of the high profile deal not only complicates the future of Yapi Kredi Bank, which is owed 2 billion USD by the group, but also that of Turkey's largest GSM operator, Turkcell, whose shares are held in trust by the bank as collateral for the loan. End Summary.

2. (SBU) Early Repayment: Pursuant to an early repayment agreement concluded in July between the Cukurova group, Banking Regulatory Board (BRSA), the SDIF, and Yapi Kredi Bank, the group received a "haircut" of nearly 2 billion USD in its outstanding debt to the bank and the SDIF (the latter debt stems largely from the failure of Pamukbank, which the group also owned) by shortening the repayment period from 2011 to 2006. From the outset much speculation surrounded the identity of the mysterious foreign investors who were providing the capital that would enable the Cukurova Group to meet its 4 billion USD in outstanding obligations, with press speculation earlier this month focusing on Central Asian and other unspecified middlemen. Officially, the source of the funds was the Northway Petroleum Corporation, an apparent paper entity whose General Manager was added to the Turkcell and Yapi Kredi boards earlier this fall.

3. (SBU) Jewel in the Crown: For Cukurova, the key enticement to the deal was the ability to hold onto the 13 percent of Turkcell shares that the bank holds in trust against the group's outstanding debts. Under its original payment protocol, the group can only hold onto the shares by paying 1 billion USD in cash by the end of January 2005. The new protocol lengthened the deadline and provided for gradual release of shares as Cukurova made its debt payments. The company, which once made Mehmet Karamehmet (who controls Cukurova) the wealthiest man in Turkey, is the group's centerpiece, and with a leading position in Turkey and growing interests throughout the region (including its recent success in a GSM license tender in Iran, albeit one now subject to review by the Iranian parliament), Turkcell appears poised to maintain its market dominance and continue to grow its overall valuation.

4. (SBU) Missed Deadline: Despite the doubts about the fund providers, most brokerages hailed the deal this summer. One typical comment, from HC Istanbul, characterized the outcome as "positive for all the parties directly involved." Given Cukurova's previously spotty record in loan repayment, however, this endorsement came with the important caveat that confidence in the plan would "gradually increase once investors see a couple of regular monthly payments by Cukurova." To date, however, no payments have been registered. Instead, the payment deadline was first moved from early September to late September, and ultimately to October 11. The Group briefly claimed on October 11 that it had made the necessary payment in the United States, but that the Columbus Day holiday had prevented transfer of funds to Turkey. That claim swiftly disappeared, however, as the group proved unable to produce a deposit receipt and as the funds failed to appear again on October 12.

5. (SBU) Next Steps: Still unclear is what the next step in the process will be. The SDIF, which has less at stake, has indicated that Cukurova can combine the first and second payment, together with interest, and maintain the revised protocol. Both Yapi Kredi Bank and the BRSA, however, have said that failure to produce the money on October 12 rendered the revised protocol null and void. Most critically for Cukurova, that would enable Yapi Kredi to sell the Turkcell shares it holds as early as the end of January. Already a number of companies have expressed interest, including Telia-Sonera, the company's minority Finnish partner, which

could assume majority control of the company by buying the pledged shares.

16. (SBU) What Went Wrong: Cukurova Chairman Karamehmet is notoriously tightlipped, but already there is speculation that the group's unidentified fund providers balked at contributing once they realized that the collateral they had been promised fell short of the amount they were being asked to provide. As evidence, some note that the fund providers had asked that bank shares be provided to them as collateral as well, something explicitly prohibited by the early repayment agreement, since their eligibility to run a bank in Turkey was open to question. In a statement late Thursday, Cukurova claimed that the delay in payment was entirely the fault of its lenders, as though this somehow absolved it of responsibility.

17. (SBU) Yapi Kredi Still Healthy: Both the Chief Sworn Auditor (bank inspector) of BRSA and Yapi Kredi executives told econoffs that, despite the market concerns, Yapi Kredi is still a sound institution. One YKB executive told us the Turkcell shares held by YKB have appreciated in value from \$1.5 billion to \$7-8 billion over the past 2.5 years. Moreover, he opined that some groups such as Koc, Sabanci or Telia Sonera would be very interested in paying a substantial premium for these shares. The Sworn Auditor said YKB is adequately capitalized and has a good image. A second YKB executive worried about the effect of the uncertainty could have on YKB's image, a concern similar to that voiced by BRSA Chairman Bilgin in a meeting this summer.

18. (SBU) How the Cukurova-Yapi Kredi end game plays out is important for several reasons. First and foremost, as BRSA Chairman Bilgin has told us privately, Yapi Kredi is one of Turkey's major banks, and problems at Yapi Kredi have implications for the entire banking sector. YKB executives have told us that BRSA stays in close, solicitous touch with YKB management. This case is also important for the credibility of the relatively new leadership of BRSA and SDIF. Cukurova is only one of the owners of failed banks that the regulators--backed by the GOT--have been pressuring into finalizing deals to honor intervened banks' loans to these owners' other companies. But Cukurova is the most important of the remaining cases because of the large amounts involved and Yapi Kredi's size and importance. If SDIF and BRSA are perceived as insufficiently tough on Cukurova, this could hamper the regulators' ability to enforce other deals with failed bank owners. Finally, the Cukurova arrangement raises questions about the source of the funds the group is bringing in to make its payments. Though markets and even regulators seem to be mainly focused on whether Cukurova can come up with the money, if the source of the funding is not clear, it would raise doubts about possible tax evasion or money laundering. End Comment.
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